

**STATE OF ILLINOIS
ILLINOIS COMMERCE COMMISSION**

Illinois Commerce Commission)	
on its own motion)	Docket No. 01-0705
)	
Northern Illinois Gas Company d/b/a NICOR)	
Gas Company)	
)	
Reconciliation of Revenues collected under)	
Gas Adjustment Charges with Actual Costs)	
prudently incurred)	
)	
Illinois Commerce Commission)	
on its own motion)	Docket No. 02-0067
)	
Northern Illinois Gas Company d/b/a NICOR)	
Gas Company)	
)	
Proceeding to review Rider 4, Gas Cost,)	
pursuant)	
to Section 9-244(c) of the Public Utilities Act)	
)	
Illinois Commerce Commission)	Docket No. 02-0725
on its own motion)	
)	
Northern Illinois Gas Company d/b/a NICOR)	
Gas Company)	
)	
Reconciliation of Revenues collected under)	
Gas Adjustment Charges with Actual Costs)	
prudently incurred)	

**REVISED
DIRECT TESTIMONY ON REOPENING
OF
MARK MAPLE
Senior Gas Engineer
Energy Division—Engineering Department
March 9, 2011**

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1 Q. Please state your name and business address.

2 A. My name is Mark Maple and my business address is: Illinois Commerce
3 Commission, 527 East Capitol Avenue, Springfield, Illinois 62701.

4 Q. By whom are you employed and in what capacity?

5 A. I am employed by the Illinois Commerce Commission ("Commission") as a
6 Senior Gas Engineer in the Engineering Department of the Energy Division.

7 Q. Please state your educational background.

8 A. I hold a Bachelor of Science degree in Mechanical Engineering and a minor in
9 Mathematics from Southern Illinois University - Carbondale. I also received a
10 Master's degree in Business Administration from the University of Illinois at
11 Springfield. Finally, I am a registered Professional Engineer Intern in the State of
12 Illinois.

13 Q. What are your duties and responsibilities as a Gas Engineer in the Engineering
14 Department?

15 A. My primary responsibilities and duties are in the performance of studies and
16 analyses dealing with the day-to-day and long-term operations and planning of

17 the gas utilities serving Illinois. For example, I review purchased gas adjustment
18 clause reconciliations, rate base additions, levels of natural gas used for working
19 capital, and review utilities' applications for Certificates of Public Convenience
20 and Necessity. I also perform utility gas meter test shop audits. Finally, I provide
21 expert testimony in cases before the Commission, including Docket 99-0127, in
22 which Nicor Gas Company sought permission to institute the performance-based
23 program currently under review.

24 Q. What do you rely upon to conduct your analyses of the operations of gas utilities
25 serving Illinois?

26 A. Staff relies upon information provided by the gas utilities in order to review their
27 plans and operations. I send out data requests for technical data and the bases
28 for their activities and rely upon them being forthright and accurate in their
29 responses. Typically, there is no independent third party source. The
30 information I need is about the public utility and is only available from the public
31 utility. Therefore, I rely upon the data and the responses provided by gas utility
32 personnel.

33 Q. What is the subject matter of your testimony?

34 A. This testimony presents the findings of my investigation, since July 2002, of Nicor
35 Gas Company ("Nicor" or "Company"), involving the costs included in the

36 Company's purchased gas adjustment clause ("PGA") in 1999 through 2002, and
37 the Company's Gas Cost Performance Program ("GCPP" or "PBR"), which was
38 in effect in 2000 through 2002. This investigation began when the Citizens Utility
39 Board ("CUB") received a fourteen-page fax from a whistle-blower, alleging
40 certain improprieties on the part of Nicor Gas surrounding the GCPP.

41 Q. What recommendations are you making in your direct testimony?

42 A. I make three recommendations as well as discuss some of Nicor's practices
43 leading up to and during the PBR. First, I recommend that the Commission lower
44 the benchmark by \$983,511 for each of the three years the PBR was in place, to
45 reflect the actual costs of contracts signed by Nicor before the final order was
46 issued in Docket No. 99-0127.

47 Second, I recommend that the Commission lower the benchmark by \$3,928,981
48 for each of the three years the PBR was in place, to reflect the correct amount of
49 capacity management credits that should have been included in the original
50 benchmark.

51 Third, I recommend that the Commission order Nicor to refund \$3,216,169 to
52 customers, due to capacity management credits that the Company should have
53 obtained for customers in 1999.

54 The combined impact of these three recommendations is a refund to customers
55 of \$10,584,908, as shown in Table 1 below.

Table 1 Recommendation	Decrease in Benchmark or Costs	No. of Years Decrease is Applicable	Applicable Ratepayer Share	Refund
#1 (contracts)	\$983,511	3	50%	\$1,475,267
#2 (cap mgmt credits 2000-02)	\$3,928,981	3	50%	\$5,893,472
#3 (cap mgmt credits 1999)	\$3,216,169	1	100%	\$3,216,169
Total				\$10,584,908

56 Finally, my testimony addresses several of Nicor's acts and omissions related to
57 the PGAs and the PBR from 1999 through 2002. This factual background
58 supports in a general sense some of Staff witness Zuraski's adjustments, as well
59 as my own.

60 Q. What did you rely upon when you conducted your analysis in this docket?

61 A. After the July 16, 2002 Interim Order was entered, Staff and the parties
62 proceeded to conduct discovery. I relied upon the responses to discovery,
63 including the discovery depositions which were conducted in June through July of
64 2003 in conducting my analysis and formulating my opinions.

65 Q. What discovery depositions are you referencing?

66 A. During the discovery phase of this case, pursuant to motions filed by Staff on
67 May 30 and July 22, 2003, discovery depositions were taken of thirteen Nicor
68 employees and officers in order to help determine what had taken place at Nicor
69 in regards to the PGAs and PBR. In my testimony below, I cite the transcripts of
70 those depositions, as well as the testimony put forth by Nicor during the original
71 PBR case in Docket No. 99-0127. The reader may be unfamiliar with the various
72 Company deponents and their positions and duties within the Company.
73 Therefore, I provide in this section a basic description of the various deponents
74 that I quote in my testimony. It is important to note that the majority of these
75 Nicor employees were either fired or forced to resign shortly after this
76 investigation began (Nicor response to data request ICC 42.01).

77 **Short Biographies on Company Employees Cited**

78 George Behrens

79 Mr. Behrens became the Treasurer and Vice President of Administration of Nicor
80 in early 2002. From 1996 to 2002, Mr. Behrens was Vice President of
81 Accounting for Nicor. Mr. Behrens was responsible for overseeing the financial
82 aspects of the company. This included monitoring the PBR and evaluating the
83 resulting profits or losses. Mr. Behrens was also a witness in this proceeding and
84 filed testimony in support of the PBR. Mr. Behrens involuntarily resigned from

85 the Company in June of 2006 (Id.).

86 Leonard Gilmore

87 Mr. Gilmore has been employed by Nicor for 30 years and currently serves as
88 the General Manager of Gas Supply. During the PBR, he was the Manager of
89 Pipeline Regulation and Supply Planning. Among other duties, Mr. Gilmore was
90 responsible for negotiating pipeline transportation and storage contracts.

91 Mr. Gilmore was a witness in the 99-0127 PBR case, where he testified in
92 support of the PBR. Specifically, Mr. Gilmore was involved in the conception of
93 the various components of the benchmark, including the Firm Deliverability
94 Adjustment and the Storage Credit Adjustment.

95 Albert Harms

96 Mr. Harms was employed by Nicor from 1972 - 2003. During the PBR, he was
97 the Manager of Rate Research, a position he held for approximately 17 years.
98 Among other duties, Mr. Harms was in charge of overseeing the majority of
99 filings made with the Commission. He also acted as a liaison to ICC Staff and
100 assisted Staff with its discovery process. Mr. Harms was a witness in the 99-
101 0127 PBR case and testified in support of the PBR.

102 Beth Hohisel

103 Ms. Hohisel started her employment at Nicor in 1985. During the PBR, she was

the Manager of Supply Services, which she held since 1998. Among other duties, Ms. Hohisel was responsible for managing the Company's supply of natural gas, including buying and selling supplies. Ms. Hohisel was terminated by the Company in August of 2004 (Id.).

Theodore Lenart

Mr. Lenart started his employment at Nicor in 1997. He was the Assistant Vice President of Supply Operations at Nicor from 1999 to his departure from Nicor. Mr. Lenart was responsible for overseeing storage operations, gas control, and gas purchasing. Mr. Lenart was terminated by the Company in August of 2004 (Id.).

Jeffrey Metz

Mr. Metz was employed by Nicor from 1981 - 2005. In mid-1999, Mr. Metz was promoted from the position of Director of Management Accounting to the position of General Manager of Accounting. In 2000, he was promoted to the position of Assistant Vice President and Controller. In January of 2003, Mr. Metz was promoted to the position of Vice President and Controller at Nicor. During the years 1999 - 2002, Mr. Metz was responsible for a number of departments, including Gas Supply Accounting. Among other duties, Mr. Metz was responsible for overseeing the accounting of the PBR program and reporting those results to Nicor officers. Mr. Metz involuntarily resigned from the Company

124 in January of 2005 (Id.).

125 Richard Rayappan

126 Mr. Rayappan was employed by Nicor from 1999 - 2004. His final position was
127 Manager of Treasury and Investments at Nicor. From October 2000 to July
128 2003, Mr. Rayappan was the Director of Supply Accounting at Nicor. Among
129 other duties, Mr. Rayappan was responsible for reviewing the accounting of the
130 various components of the PBR, and for calculating Nicor's financial
131 restatements due to the findings of the Lassar Report. Mr. Rayappan was
132 terminated by the Company in August of 2004 (Id.).

133 Lonnie Upshaw

134 Mr. Upshaw worked for Nicor from 1977 to 2002. During that time he held
135 various positions related to gas transmission and storage operations, with his last
136 position being Vice President of Supply and Technical Services. Mr. Upshaw
137 was one of the employees responsible for the conception and implementation of
138 the PBR. Among other duties, Mr. Upshaw was in charge of overseeing the
139 implementation of the PBR, especially from a transactional and supply viewpoint.
140 Mr. Upshaw was terminated by the Company shortly after the release of the
141 Lassar Report in 2002 (Id.).

142 Low Cost LIFO Layers in Storage

143 Q. Explain your understanding of Nicor's physical storage options.

144 A. Nicor uses a combination of Company owned storage and leased storage
145 services. Nicor owns a number of underground storage fields in Illinois, which
146 make up the majority of the Company's storage capacity. Nicor also leases
147 storage from interstate pipeline companies to provide a seasonal price hedge,
148 extra peak day deliverability and balancing services.

149 Q. What accounting method does Nicor use for its storage inventory?

150 A. Nicor uses the LIFO ("Last In, First Out") inventory costing method. Thus, when
151 Nicor withdraws gas from storage, it is assumed that the most recently created
152 layers are removed first for accounting purposes.

153 Q. How does LIFO accounting affect the price of gas in storage?

154 A. At the end of each calendar year, Nicor totals the injections and withdrawals to
155 determine if there was a net injection or withdrawal for the year. If there was a
156 net injection, there would be a "layer" of gas created in inventory that is priced at
157 the average cost of gas for the entire year. If there was a net withdrawal, the
158 Company first reduces the top layer of storage gas. If the net withdrawal was
159 large enough, the Company could eliminate one or more layers of inventory.

160 Q. How has LIFO accounting affected Nicor's storage inventory over the years?

161 A. Decades ago, Nicor experienced significant net injections, which created layers
162 of storage gas. This gas was acquired at a price far below what the market
163 charges today. As the storage fields were developed and end-of-year storage
164 balances grew, these low-cost LIFO layers became increasingly “trapped,” albeit
165 strictly in an accounting sense. That is, due to the LIFO accounting method, it
166 became increasingly unlikely that these lower priced layers would be accessed,
167 unless Nicor withdrew more gas than it injected over a number of consecutive
168 calendar years.

169 Q. Has Nicor always recognized the embedded value of these low-cost LIFO
170 layers?

171 A. Nicor may have been conscious that some of those layers were priced well below
172 current market prices. However, it did not recognize the potential for
173 shareholders to tap into this value until late in the 1990’s. In fact, the Company
174 failed to recognize that either the value or the mechanism to extract that value
175 existed when the Company filed its first PBR in 1996, as Jeffrey Metz explained
176 during his deposition:

177 *Through those discussions [with the Company’s tax manager, Jeff*
178 *Gabriel in 1998], I recognized that the PBR we had proposed in 1996*
179 *would capture the value of the LIFO reduction. We did not realize that*
180 *throughout the 1996 filing process. But in these discussions became*
181 *aware that that was a potential value (Metz Transcript, p. 64).*

182 Q. Did the Company take steps to further develop Mr. Metz’s idea for shareholders

183 to profit from the low-cost LIFO layers?

184 A. Yes. In 1998, a group of Nicor employees were assembled into what became
185 known as the "Inventory Value Team." The mission of the team was to quantify
186 the value of the low-cost LIFO layers and develop strategies to extract that value
187 for shareholders. This is substantiated in the depositions of three of the
188 Company's employees, two of which were on the Inventory Value Team:

189 *Jeffrey Metz:*

190 Q. *Would you say that you or the members of the Inventory Value Team were*
191 *the individuals who generated the idea to, if it's not your term, to monetize*
192 *the LIFO layer?*

193 A. *The purpose of the Inventory Value Team was to look at different ways of*
194 *monetizing the LIFO inventory value. (Metz Transcript, p. 66).*

195 *Leonard Gilmore:*

196 Q. *What was the team's purpose?*

197 A. *The purpose was to look into ways of generating value for the Company*
198 *based on the fact that there was low-priced gas in storage. (Gilmore*
199 *Transcript, p. 15).*

200 *Theodore Lenart:*

201 Q. *And were you -- how did you first become aware of the plan?*

202 A. *I was aware that there was a team put together to review the -- the*
203 *monetizing, the potential monetizing of inexpensive LIFO layers. (Lenart*
204 *Transcript, pp. 20-21).*

205 Q. Was the Inventory Value Team able to quantify the value of the low-cost LIFO

206 layers?

207 A. Yes. The Team wrote a report, the Inventory Value Team Report ("Report"), in
208 October 1998 in which they quantified the value of LIFO layers. On page three of
209 the Report, the Team valued the layers at a book value of \$128 million.
210 Additionally, the layers had a market value of between \$93 - \$203 million in
211 excess of the book value. (Stipulated Exhibit 1, p. 3, NIC 049927).

212 Q. What did the Inventory Value Team conclude, and what happened following the
213 issuance of the Inventory Value Team Report?

214
215 A. On page 2, Roman II of the team's Report, it states, "We recommend that the
216 company 'capture' the LIFO inventory value by filing and implementing a Gas
217 Rate Performance Plan (GRPP) related to gas costs." (Stipulated Exhibit 1, p. 2,
218 NIC 049926).

219
220 Following the issuance of the Report, the team made a formal presentation to
221 many of the Company's corporate officers and high ranking supervisors.
222 Attendees at the presentation included George Behrens, Tom Fischer, Kathy
223 Halloran, and Phil Cali. Inventory Value Team members Paul McLean and Jeff
224 Gabriel presented a slide show along with the Team's recommendation "that the
225 PBR was an appropriate means to capture the inventory value." (Metz Transcript,
226 p. 69-70) At the meeting, the "LIFO potential" was made known to the officers,
227 with a specific slide posing the question "Is this right?" (Metz Transcript, p. 71)

228

229 Mr. Metz described the slide as follows:

230

231 “The slide I believe was just a simple bullet that said, ‘Is this the right thing to do
232 or is this right.’ Whether that was a shareholder asset or a customer asset. That’s
233 what the slide was getting to, asking that question.” (Metz Transcript, p. 72)

234

235 Asked what were the discussions surrounding that slide, Mr. Metz stated: “I don’t
236 remember the discussion other than a directive to the team to prepare – come
237 back for a second presentation answering various questions. And one of the
238 questions was to get legal input on that question.” (Metz Transcript, pp. 72-73)

239

240 The second presentation was attended by “most of the officers.” (Metz
241 Transcript, p. 75) Mr. Metz described the issues addressed at the presentation:
242 “one of the questions dealt with the legal input on the ‘is this appropriate,’ which
243 was addressed by Paul McLean. I addressed some of the accounting issues
244 associated with the PBR, the interim-accounting issues and what it would do to
245 our earnings predictability and earnings’ volatility.” (Metz Transcript, p. 74) Mr.
246 Metz stated that he did not recall the specifics of the discussion about “whether it
247 was appropriate,” but that he did recall the conclusion: “The conclusion was – is
248 that it is appropriate, and that there was no need to disclose it in our testimony.
249 And that’s the conclusions (*sic*) I took away from it.” (Metz Transcript, pp. 74-75)

250

251 Shortly after the second presentation, a conclusion was made that a PBR would
252 be filed (Metz Transcript, pp. 87-88), and Mr. Metz was assigned to write
253 testimony for Nicor witness Ed Werneke, and to “participate in determining
254 whether there should be any changes to the benchmark formula that had been
255 proposed in the 1996 filing.” (Metz Transcript, p. 89)

256

257 It is clear from the deposition transcript of Nicor employee Ted Lenart that the

258 existence of low-cost LIFO layers played a large part in Nicor's decision to
259 implement a PBR:

260
261 *The proposal to develop a PBR was not so much driven by what we could do*
262 *from a supply operation standpoint to profit under a PBR but was largely driven*
263 *by the potential value of liquidating the LIFO layers. (Lenart Transcript, p. 34)*

264
265 It is also clear from his deposition that he was not alone in that view:

266
267 *Q. Did anyone at the Company ever indicate to you that they considered one*
268 *of the main points or purposes of the PBR proposal was to enable the*
269 *Company to share in the value of low cost LIFO layers?*

270 *A. In discussions I had maybe with Lonnie we probably talked about that,*
271 *yes.*

272
273 *Q. And did he hold that opinion that that was the purpose?*

274 *A. That was the underlying motive, if you will. (Lenart Transcript, p. 35)*

275 Q. Do you believe that the Company would have pursued a PBR if there were no
276 low-cost LIFO gas?

277 A. I believe that Nicor would not have pursued the PBR in 1999, absent the ability to
278 generate savings by tapping into the low-cost LIFO gas. Consider the sworn
279 depositions of two key Company employees, Mr. Upshaw and Mr. Lenart:

280 Lonnie Upshaw:

281 Q. *Mr. Upshaw, if Nicor was not able to capture value from the low cost LIFO*
282 *layers, would you have recommended that the Company proceed with the*
283 *PBR plan?*

284 A. No. (Upshaw Transcript, pp.119-120)

285 Theodore Lenart:

286 Q. *Mr. Lenart, calling your attention to the discussion of the background of*
287 *the PBR in the first couple of sentences, the interview memo reports that*
288 *you stated something to the effect that the PBR process was driven by*
289 *accounting issues with respect to low cost LIFO layers. Do you see that?*

290 A. Yes, I do.

291 Q. *What did you mean by that?*

292 A. *The proposal to develop a PBR was not so much driven by what we could*
293 *do from a supply operation standpoint to profit under a PBR but was*
294 *largely driven by the potential value of liquidating the LIFO layers. (Lenart*
295 *Transcript, pp. 33-34)*

296 Additionally, consider the text from a presentation given by Nicor management:

297 *"The first [important issue of the PBR] has to do with recognizing that the*
298 *value of low cost gas in inventory balances we hold in storage was a key*
299 *driver to go forward with a performance based rate plan...If we weren't*
300 *able to exploit this asset through the PBR mechanism the PBR would be*
301 *too risky, more so in the current pricing environment." (Stipulated Exhibit*
302 *3, NIC 012162).*

303 Q. Why was the existence of the low-cost LIFO layers so critical to the Company's
304 acceptance of a PBR program?

305 A. The LIFO layers were basically a guaranteed moneymaker in an otherwise risky

306 and uncertain PBR program. In fact, almost every Company witness deposed by
307 Staff referred to the LIFO layers as insurance or risk mitigation. Company
308 witness Mr. Lenart sums it up well in his sworn deposition statements:

309 Q. *Would it be correct to say that the company could have used the LIFO gas*
310 *and storage to mitigate the risks?*

311 A. *That was our hedge.*

312 Q. *And I'm referring to the risks that you just referred to.*

313 A. *Yes.*

314 Q. *So it would have, in effect, using the LIFO layers would have eliminated*
315 *those risks?*

316 A. *Done properly it would have mitigated those risks, yes.*

317 Q. *And this insurance policy aspect of the LIFO layers, would that play a*
318 *major role in the decision to proceed forward with the PBR program?*

319 A. *Yes. (Lenart Transcript, p. 65)*

320 Q. Given that the low-cost LIFO layers were so valuable and seemed to play such
321 an important role in the decision to implement the PBR, did Nicor tell Staff and
322 the other interveners about the significance of these layers during the 1999
323 case?

324 A. No, it did not. The Company did not provide any information regarding the
325 Company's plans to monetize the low-cost LIFO layers during the 1999 case.

326 As I will discuss later, Nicor withheld relevant documents from Staff in response

327 to data requests, and changed the format of reports to hide the LIFO benefit.

328 Furthermore, according to four key Nicor employees, there was a shared sense

329 among Company employees that the LIFO benefit was not to be “highlighted.”

330 Q. Do you think during the 1999 PBR case, in the absence of any notice from the

331 Company of its plans, Staff should have been aware of the potential for Nicor to

332 monetize the layers and profit from them?

333 A. No. First, one must understand that Staff is highly dependent on the Company to

334 provide accurate and reliable information during cases. For much of the

335 information concerning the Company’s physical and financial transactions, Staff

336 cannot go to a trade publication or to some third party for investigation. That

337 information must come from Nicor itself. As I will discuss later in testimony, Nicor

338 withheld this information and misled Staff on its intentions concerning storage

339 gas. It doesn’t matter what had been provided in cases from previous years – all

340 information relevant to the 1999 case should have been disclosed during that

341 case. The fact of the matter is that Nicor did not disclose anything about either

342 the status of its LIFO inventory or its intent to tap into that value.

343 Second, even if Staff members knew or should have known about the existence

344 of the LIFO layers that is still a far cry from Staff knowing that Nicor had

345 discovered a viable scheme to monetize these low-cost layers by manipulating

346 net withdrawals. In fact, Staff was repeatedly told in Nicor’s testimony and data

347 request responses during the 1999 PBR case that Nicor had no ability to change
348 its storage withdrawal patterns. This is important because the LIFO layers could
349 only be accessed if Nicor changed its withdrawal patterns, since on average
350 Nicor had been injecting more gas than it had been withdrawing. Consider the
351 testimony of Mr. Gilmore in 99-0127:

352 *...The Company's ability to control the timing and quantity of withdrawals*
353 *is therefore very limited. (Stipulated Exhibit 4, Company's Response to*
354 *Staff Data Request ENG 1.1, 99-0127).*

355 *...Accordingly, the Company has no incentive under the GCPP to*
356 *inappropriately shift storage. (Gilmore Rebuttal, p. 6, 99-0127).*

357 *...Mr. Iannello's reason for proposing alternatives to the Company's*
358 *computation is his claim that the Company has an incentive to manipulate*
359 *storage withdrawals. As I have shown, this claim is incorrect. (Gilmore*
360 *Rebuttal, pp. 6-7, 99-0127).*

361 During oral arguments before the Commissioners, Company attorney
362 Mr. Mattson even scoffed at Staff's allegations that Nicor could manipulate
363 storage withdrawals, saying:

364 *And they [Staff] said, ah-huh, we found a way you can manipulate the*

365 system. ***In the real world that couldn't happen.*** (emphasis added)

366 (Transcript of November 2, 1999 Oral Arguments, p. 55).

367 The Company and its witnesses continued to give misleading information to
368 Staff, while an internal memo from Nancy Brucher to Al Harms documents that
369 the Company was engaged in planning to use the PBR to alter injection and
370 withdrawal as early as December 1998:

371 ...Since the timing of injections and withdrawals may be altered under the
372 PBR, by assuming additional risk related to seasonal pricing, the amount of
373 capacity available for these services and the timing of when it is available may be
374 altered. (Stipulated Exhibit 16, NIC 003213).

375 Third, as explained later in my testimony, Nicor made it a point to “not highlight”
376 its intentions of monetizing the LIFO layers. Thus, as Nicor’s liaison to the ICC,
377 Mr. Harms, acknowledged during his deposition,

378 LIFO was not brought up in that case [Docket 99-0127]. I do not believe
379 the Commission Staff or the Commission would have been thinking about
380 that. (Harms Transcript, p. 202). ... I don't believe they had knowledge
381 of that [Nicor’s intention with respect to the LIFO layers]. (Harms
382 Transcript, p. 227).

Finally, Nicor was using practices that were new to Staff. Knowing that the Company had value stored in low-cost LIFO layers did not endow Staff with the knowledge of how or if Nicor would extract that value. Staff attempted to investigate Nicor's potential to manipulate storage withdrawals. But because Nicor provided Staff with incomplete answers and misleading testimony, Staff was unable to detect Nicor's intentions to monetize the LIFO layers.

Inflation of the Firm Deliverability Adjustment Component

Q. What is the Firm Deliverability Adjustment?

A. The Firm Deliverability Adjustment (FDA) is one of the components of the PBR benchmark. It was conceived by the Company and accepted by the Commission in the 1999 PBR case (Docket 99-0127). The FDA was set at \$116,582,612 for the duration of the PBR and did not fluctuate with the market. The FDA was an attempt to represent Nicor's annual fixed costs for reserving firm transportation and purchased storage capacity, less credits received by the Company when it releases excess capacity, sells excess gas, or conducts certain other transactions.

Q. How did the Commission establish the \$116,582,612 FDA value in Docket 99-0127?

401 A. The Commission agreed to use Staff's methodology of averaging the projected
402 costs and credits over the first two years of the PBR program, 2000 and 2001,
403 since the benchmark would only be in place for two years before a review was
404 initiated. (Section 9-244(c) of the Illinois Public Utilities Act mandated that the
405 Commission review the program after two years to ensure that it was meeting its
406 objectives.)

407 Q. How did Staff project the costs and credits that Nicor was likely to incur and
408 receive during 2000 and 2001?

409 A. Many of the pipeline and storage costs were known because the Company had
410 already signed multi-year contracts. However, there were two uncertain issues:
411 1) Nicor's estimates of capacity management credits to be earned during the
412 PBR; and 2) the costs to reserve capacity on the Midwestern and Tennessee
413 Pipelines. Staff contested the Company's original positions with respect to these
414 two issues.

415 Q. Did the Commission side with Nicor or Staff on these two issues?

416 A. Actually, the Commission reached a compromise on both issues.

417 Q. Was the Commission provided with all the relevant information necessary to

418 make a sound determination on those issues?

419 A. No. Nicor withheld and/or manipulated crucial information throughout the 1999
420 docket. This deprived the Commission of a full and complete record upon which
421 to base its decision. I recommend that the FDA should be reconsidered now that
422 that crucial information is available. To the extent the FDA component was
423 arrived at based upon the Company's manipulation of both the revenues and the
424 negotiation processes, the use of it does not result in an equitable sharing of the
425 net economic benefits of the PBR between the utility and its customers. I
426 recommend that the benchmark be modified to accurately reflect the FDA

427 Q. To what crucial information are you referring?

428 A. Through my investigation since July 2002, I have determined that Nicor withheld
429 information from Staff and manipulated both its revenues and its negotiation
430 processes in order to establish a higher FDA. This higher FDA, in turn, resulted
431 in a PBR benchmark that was more favorable to the Company. I note further that
432 Nicor's manipulation not only affected the benchmark and the computation of
433 savings under the PBR program, but also served to directly increase costs to
434 ratepayers in 1999. Below, I provide an explanation of the two issues.

435 **Negotiations with Midwestern & Tennessee Pipelines**

436 Q. Why was Nicor negotiating with Midwestern and Tennessee Pipelines?

437 A. Midwestern Gas Transmission Company ("Midwestern") and Tennessee Gas
438 Pipeline Co. ("Tennessee") are two interstate pipelines that Nicor uses to
439 transport gas to its system. In 1999, Nicor had contracts in place with both
440 pipelines. These contracts were set to expire in October 2000. It was typical
441 practice for Nicor to start negotiating new contracts with the pipelines well in
442 advance of the contract expiration date to ensure that service was not
443 interrupted. Nicor does not typically purchase capacity from the pipelines at
444 maximum rates, but rather it uses its size and market position to negotiate
445 discounts.

446 Q. What was Staff's issue during the 1999 PBR case?

447 A. On March 22, 1999, Nicor received an initial offer from the pipelines for the new
448 contracts that would go into effect in October 2000. As with most negotiation
449 processes, the first offer is often the highest offer and is unlikely to represent the
450 final accepted terms. Nicor attempted to use the initial offer as the basis for
451 setting the FDA. Staff argued that it was extremely likely that Nicor would
452 negotiate rates lower than the initial offer, which would then leave the benchmark
453 artificially high and detrimental to ratepayers. Thus, Staff recommended that the
454 Commission assume a certain percentage discount would be achieved with

455 Midwestern and Tennessee.

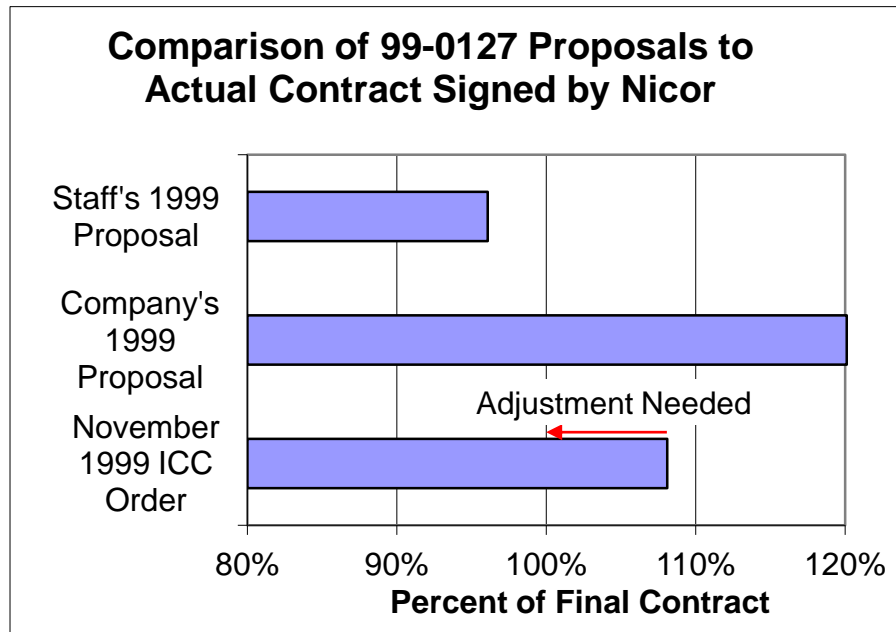
456 Q. What did the Commission decide on this issue?

457 A. The Commission agreed that a discount was likely, although it disagreed with
458 Staff on the magnitude of this discount. Ultimately, the Commission decided that
459 a discount half the size of Staff's proposal was likely.

460 Q. Did the Company actually realize a discount from the Midwestern/Tennessee
461 negotiations?

462 A. Yes. The actual discount received was greater than the value accepted by the
463 Commission, but slightly lower than Staff's prediction. However, the results
464 validated Staff's argument that Nicor could realize significant discounts during the
465 negotiation process.

Table 2			
Annual Cost for New Midwestern / Tennessee Contracts			
<i>October 1999 Final Contract</i>	<i>November 1999 ICC Order</i>	<i>Company's 1999 Proposal</i>	<i>Staff's 1999 Proposal</i>
\$ 15,501,420	\$ 16,756,176	\$ 18,617,976	\$ 14,894,376



466

467 Q. Did Nicor do anything during the 99-0127 proceeding to overstate the likely
468 Midwestern and Tennessee contract costs and inflate the benchmark?

469 A. Yes, it now appears that Nicor deliberately halted negotiations with Midwestern
470 and Tennessee until the case was nearly over. Nicor had traditionally been
471 successful in achieving discounts through negotiations. If Nicor had negotiated
472 its discount before the proposed order was issued, the benchmark would have
473 likely reflected the entire amount of the discount. This would have correctly
474 lowered the benchmark and made it harder for Nicor to profit from the PBR.

475 Faced with this prospect, it appears that Nicor deliberately put a halt to
476 negotiations with Midwestern and Tennessee during the case. Nicor resumed
477 negotiations sometime after the HEPO was issued when no more evidence
478 would be entered into the record. Nicor finalized its contracts in October of 1999,

479 which was one month before the Commission issued its final order.

480 Q. What evidence do you have to substantiate your claims that Nicor deliberately
481 halted negotiations with Midwestern and Tennessee until Docket 99-0127 was
482 nearly over?

483 A. In the deposition given by Company employee, Len Gilmore, on July 18, 2003,
484 there was the following exchange:

485 Q. *Do you know if the negotiations for that contract were purposefully*
486 *delayed so that the result of the negotiations would not be known until late*
487 *October?*

488 A. *Well, the results were known prior to late October, although the contract*
489 *was not signed until late October. We did at one point relative to*
490 *Midwestern Tennessee contract decide to reduce our effort on it. We*
491 *understood that that may lead to negotiating results that were better than*
492 *what was on the table at that time but we had no knowledge that that*
493 *would be the result... (Gilmore Transcript, p. 210).*

494 Notably, Mr. Gilmore was the Company's witness on this issue in Docket 99-
495 0127 and was responsible for negotiating contracts with pipeline companies. I
496 have since confirmed that Nicor had agreed to terms with Midwestern and
497 Tennessee on or about October 18, 1999. (Stipulated Exhibit 5, Nicor Response
498 to data request ICC 27.01).

499 Nicor received notice from Tennessee Pipeline as far back as December 18,
500 1998 stating that the current contract would expire November 1, 2000 (Stipulated

Exhibit 15, NIC 114589-92). Furthermore, Nicor was notified that it must notify the pipeline by October 31, 1999 on its intentions to negotiate a new contract, otherwise the contract would automatically renew at maximum rates. I am aware of many of Nicor's contracts with pipelines. To my knowledge, Nicor rarely, if ever, pays maximum rates for a contract of this magnitude. Nicor had almost a full year from its first notice in which it could negotiate a new contract. However, Nicor waited until the eleventh hour to come to an agreement – right after the initial briefing phase had been completed. By doing this, Nicor avoided the inclusion of the new, lower rates in the FDA. Including the higher rates raised the FDA, making it easier for Nicor to meet the benchmark and thus create "savings." This benefited Nicor while it harmed ratepayers.

Q. What is your proposal in light of this new information?

A. In light of Nicor's deliberate delay in concluding negotiations, I recommend that the Commission apply the entire amount of the actual discount to the FDA. This would effectively lower the benchmark for 2000, 2001, and 2002. Table 3 below shows this adjustment, which amounts to a reduction in the benchmark of \$983,511 for each of the three years that the PBR was in effect.

Table 3

Midwestern & Tennessee Costs in Benchmark

2 Year Average Based on 1999 Order (Nov 99)	\$ 20,691,776
2 Year Average Based on Actual Contract (Oct 99)	\$ 19,708,265

Value of Proposed Adjustment to Benchmark	<u>\$ 983,511</u>
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518 **Capacity Management Credits**

519 Q. What are capacity management credits?

520 A. The Company reserves a large amount of interstate pipeline capacity to meet
521 system demand during the coldest peak days. During warmer, non-peak days,
522 there is an excess of capacity that goes unused by the Company. Nicor can use
523 this excess capacity to meet the needs of marketers and other utilities by
524 conducting capacity releases, buy/sells, supply sales, and storage credits.
525 Under traditional PGA regulation, the Company flows these revenues, which are
526 classified generally as capacity management credits, back to ratepayers. Under
527 the PBR, these capacity management credits continued to lower costs for
528 ratepayers, but were shared 50/50 with the Company. Thus, in Docket 99-0127,
529 a projected amount of such capacity management credits was included in the
530 PBR benchmark—specifically as a reduction in the Firm Deliverability
531 Adjustment.

532
533 Q. What amount of capacity management credits was built into the FDA in Docket
534 99-0127?

535 A. In Docket 99-0127, the Commission used a modified version of the most recent

twelve months of capacity management credits (as of October 1999) as the basis for setting the FDA. The modification, which Staff argued against, took a ratio of the last twelve months of FDA costs vs. the FDA costs established in the benchmark. This ratio adjustment, which was opposed by Staff, lowered the capacity management credits by approximately \$800,000, and resulted in an established benchmark credit of \$8,185,672.

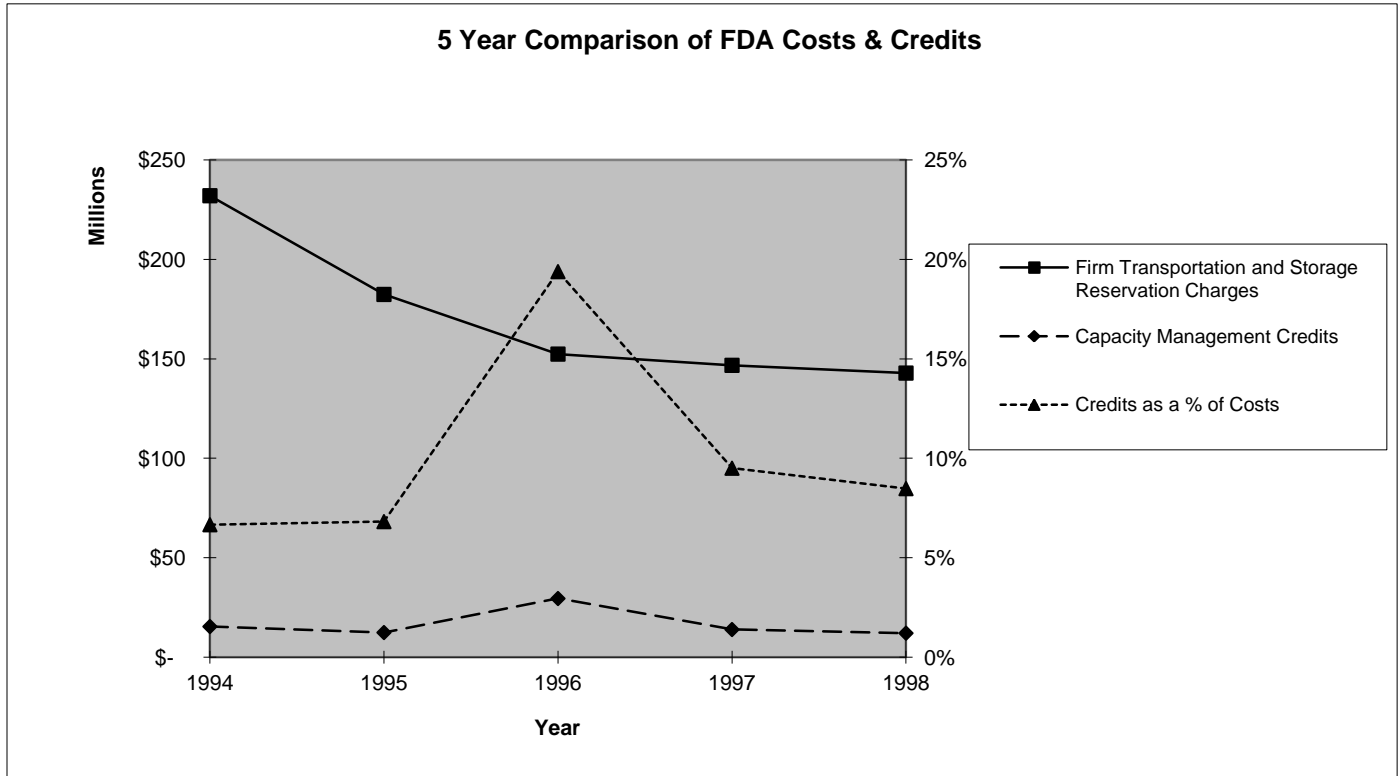
Q. What was the rationale for multiplying the last twelve months of capacity management credits by the ratio of the last twelve months of FDA costs vs. the FDA costs established in the benchmark?

A. Nicor argued that its costs to reserve transportation had been declining, and thus the market value for that capacity was also declining. (Gilmore Surrebuttal, p. 10, Docket No. 99-0127) The Commission agreed with the Company and ordered it to determine the ratio of decline for the FDA costs, and apply that ratio to the credits.

Q. Did Staff agree with Nicor's argument that capacity management credits were declining and would decline in the future?

A. No. Staff demonstrated that even though the Company had cut its FDA costs by over \$89 million over a five-year period, the capacity management credits decreased by only \$3.3 million (Staff's Brief on Exceptions, 99-0127, pp. 3-4). The credits in 1998 were actually higher as a percentage of FDA costs than they

were in 1994. So Staff argued there was no evidence that capacity management credits would decrease much, if at all, during the PBR program.



Q. The Commission ruled in favor of Nicor on this issue in 1999. Why are you recommending the Commission revisit this issue?

A. The Commission has reopened the biennial review of the results of that case (Docket No. 02-0067), and has consolidated it with several PGA reconciliations (Docket Nos. 01-0705 and 02-0725), in order to consider new evidence in light of the revelations that came to light in the summer of 2002. These revelations are outlined in the Lassar Report (Stipulated Exhibit 6) and addressed throughout Staff's testimony in these consolidated proceedings.

I believe, for example, that Nicor's failure to divulge its intent to use the PBR to

monetize the LIFO layers (see supra, pp. 12-18 and Stipulated Exhibit 1) provides additional context which should be considered by the Commission when considering the capacity management credits. The Commission should reconsider its calculation of the FDA costs and capacity management credits in light of the other problems in Nicor's presentation to the Commission and responses to discovery in matters related to the PBR, documented elsewhere in Staff's evidence. This reevaluation is necessary in order for the Commission to determine how to make Nicor's customers whole for any amounts the Commission determines Nicor to have unjustly charged.

Q. Is there anything in particular that caused you to reconsider the capacity management credits issue now?

A. Yes. When I reviewed the additional information provided by Nicor as data request responses, I saw a document that raised my suspicions about the information Nicor previously provided about the capacity management credits.

Q. Please describe that document.

A. The document is a memo from Nancy Brucher to Al Harms dated December 28, 1998 entitled "Effect of PBR on Current Services" (Stipulated Exhibit 16).¹ This memo was prepared an entire year before the PBR was put into place. The memo describes itself as "a brief summary of the potential impact of a performance based ratemaking ("PBR") mechanism on various services currently

¹ At the deposition of Al Harms on June 24, 2003, he was handed "that December 28, '98 memo" (Harms Transcript, p. 140) which document was also referred to as "NIC 003213" (Harms Transcript, p. 139). At that time, he responded in the affirmative when questioned whether he had seen the document before, and whether he had received it in December of '98 (Harms Transcript, p. 140).

588 offered by Nicor Gas.” (Stipulated Exhibit 16, p. 1) The second page of this
589 memo contains a paragraph discussing gas supply activities “such as capacity
590 releases.”

591 Q. Why did this document cause you to reconsider the capacity management credits
592 issue?

593 A. The document on its face states that it is a summary of the potential impact of a
594 PBR mechanism on services offered by Nicor Gas. Thus, I reviewed the
595 memorandum closely to determine if it had any relevance to the analysis on
596 reopening of the costs or sharing of costs in the PBR. The memo includes a
597 reference to capacity releases which brought me to the subject of Capacity
598 Management Credits.

599 Q. Did the Company have any incentive to inflate the benchmark by understating
600 capacity management credits?
601

602 A. Yes. Because the credits effectively reduce the benchmark and make it harder
603 for the Company to achieve “savings” relative to the benchmark, Nicor stood to
604 gain by somehow lowering the 1999 credits. Any reduction in such credits prior to
605 the start of the PBR would not hurt the Company because 100% of the credits
606 would have been passed back to ratepayers anyway, under the formula in the
607 Commission’s PGA rules and the Company’s PGA tariffs.

608 Q. Did Nicor have the opportunity to lower the 1999 capacity management credits?

609 A. Yes. The Inventory Value Team Report (Stipulated Exhibit 1), which
610 recommended that Nicor implement a GCPP in order to monetize the LIFO

611 layers, was issued in October 1998. (Co. Response to Staff DR ICC 2.14) The
612 Inventory Value Team Report expressly recognizes the effect of capacity
613 management credits on the benchmark:

614

615 Revenues that lower the benchmark are capacity release revenues
616 (includes buy-sells, linked purchases and sales) and storage
617 management credits. Capacity release credits for 1998 are
618 forecasted to be \$9.5 million and 1998 credit from storage
619 management will be about \$5.2 million. Subsequent years should
620 generate similar credits. [Stipulated Exhibit 1, p. 12, NIC 049936]
621

622 This shows that Nicor recognized the adverse affect that these credits would
623 have on the benchmark, and thus Nicor's profit under the PBR. In order to
624 lessen this adverse affect, Nicor would need to change its capacity management
625 strategy for 1999 to lower the credits it obtained for customers.

626 Q. Could Nicor have changed its capacity management strategy for 1999 within that
627 time period?

628 A. Yes. Utilities structure most of these capacity management transactions for
629 periods of less than one year. In fact, many of them are transacted on a monthly
630 or even daily basis. When the Inventory Value Team Report was written, it is
631 unlikely that very much, if any of the 1999 capacity management transactions
632 were already locked in place. Therefore, there was plenty of time to change its
633 capacity management strategy in 1999.

634

635 Q. Is there any evidence that Nicor generated lower capacity management credits in
636 1999 than in the years immediately before and after 1999?

637

638 A. Yes. The actual numbers for capacity releases in 1998, 1999, and 2000 show
639 that the capacity management credits Nicor generated in 1999 were significantly
640 lower than the capacity management credits generated in the other years. This
641 decrease occurred despite the 1998 forecast that projected credits for 1999 that
642 were in line with the other years (Id).

643

644 Q. Please elaborate on the numbers demonstrating Nicor's capacity release
645 performance during those three years.

646 A. Refer to Table 4 below. In 1999, the credits dropped to the lowest level in recent
647 history, down more than \$3.2 million from the previous year. But as soon as the
648 PBR went into effect, the credits increased substantially by more than \$8 million.
649 Not only did the Company generate extraordinarily low capacity management
650 credits during 1999, but also it outperformed historical levels during 2000. This is
651 contrary to the position that the Company so vigorously argued in 99-0127, that
652 credits would continue to decline into the future due to lower prices and lower
653 market demand.

654

Table 4		
Capacity Management Credits		
<i>1998</i>	<i>1999</i>	<i>2000</i>
\$ 12,114,653	\$ 8,898,484	\$ 17,588,882

655 Q. Did lowered revenues from capacity releases during 1999 only hurt customers
656 during the PBR, through its effect on the benchmark?

657 A. No. It is true that customers were hurt during the PBR by having an inflated
658 benchmark. However, customers were also hurt in 1999 by Nicor's lax attempts
659 to earn credits for the ratepayers, of which customers would have received 100%
660 of the benefits.

661 Q. What adjustments do you propose as a result of the Company's manipulation of
662 the 1999 capacity management credits?

663 A. My adjustment is twofold. First, the Company should have worked harder in
664 1999 to earn credits for customers. By looking at the credits from 2000, one
665 could easily argue that Nicor should have received over \$8 million more in 1999.
666 However, I recognize that the PBR gave the Company incentive to "turn over
667 new stones" to realize more credits. But it is totally conceivable that in 1999, the
668 Company could have replicated its performance in 1998, where it earned \$12.1
669 million in credits. I believe that had Nicor not reined in its efforts to generate
670 capacity management credits in the months prior to the order in the 99-0127
671 proceeding, it would, at a minimum, have replicated its 1998 performance.
672 Therefore, my first adjustment is to increase the amount of credits received in
673 1999 by \$3,216,169. These credits should be refunded to customers as part of

674 the PGA reconciliation for 1999.

675 My second adjustment is to lower the FDA portion of the benchmark for years
676 2000-2002. I am making this adjustment to reflect the higher level of capacity
677 management credits that should have been “built into” the FDA. The \$8,185,672
678 level of credits was inaccurate for two reasons: 1) the use of the most recent
679 year’s worth of credits through October 1999, which were artificially low due to
680 Nicor’s apparent strategy of reducing capacity release credits in 1999; and 2)
681 Nicor’s self-serving and faulty argument that the credits should be further lowered
682 to reflect a weaker outlook on future credit opportunities. Thus my adjustment
683 would establish the benchmark value of capacity management credits to be
684 \$12,114,653. This in turn would lower the FDA by \$3,928,981 for each of the
685 three years it was in effect.

686 **Savings Under the Benchmark**

687 Q. Please explain the relationship between the benchmark and savings.

688 A. The benchmark was created to set a standard against which Nicor’s performance
689 under the PBR could be measured. The benchmark was to reflect what actual
690 gas costs would have been under the traditional purchased gas adjustment
691 clause. To the extent that the benchmark was manipulated to be higher than gas
692 costs would have been in the absence of the PBR, it does not serve as an

693 accurate standard. The benchmark will only accurately determine whether
694 savings have been realized to the extent the benchmark is an accurate indicator
695 of what gas costs would have been under traditional regulation. If the benchmark
696 was not an accurate reflection of what gas costs would have been under
697 traditional regulation, then differences between the benchmark and actual gas
698 costs do not reflect savings to customers. In other words, the benchmark is an
699 artificial standard; the customers NEVER realized savings due simply to the
700 difference between the benchmark and actual gas costs. In fact, the customers
701 paid Nicor 50% of the difference between the benchmark and actual gas costs.
702 To the extent the benchmark was inflated, the customers paid Nicor 50% of costs
703 that did not reflect real savings. Any savings the customers realized are due
704 strictly to the lowering of actual gas costs, irrespective of the benchmark, and
705 even then customers realized only 50% of such savings. Conversely, Nicor
706 realized savings ONLY from the difference between the benchmark and actual
707 gas costs. By inflating the benchmark, it was easier to beat; there was a broader
708 range in which customers would be paying 50% of the so-called savings.
709 Lowering actual gas costs was only profitable to Nicor if it increased the spread
710 between gas costs and the benchmark.

711 Therein lies the problem, which is that Nicor had an incentive to inflate the
712 benchmark both during its creation and during the operation of the PBR program.
713 If Nicor could establish a benchmark that was greater than normal gas costs,

714 Nicor would be able to profit from “savings” without truly lowering gas costs and
715 showing real savings for customers. Nicor did indeed inflate the benchmark in
716 1999, as I illustrated in my arguments regarding the Midwest/Tennessee
717 contracts and the capacity management credits. As Staff Witness Richard
718 Zuraski will testify, Nicor was also able to manipulate and inflate the benchmark
719 during the PBR program by selectively using schemes such as virtual storage
720 and infield transfers. Therefore, Nicor was able to show “savings” that allowed
721 them to profit while actually increasing gas costs for ratepayers.

722 Q. Were the “savings” realized during the life of the PBR due to better planning,
723 improved purchasing strategies, or other efficiencies on Nicor’s part?

724 A. No. While I do not suggest that every strategy Nicor used ended in failure and
725 losses, apparently most of the Company’s strategies to generate “savings” were
726 unsuccessful, even by Nicor’s own calculations. By looking at Nicor’s year-end,
727 pre-restatement “PBR Buckets” reports, we can see where Nicor estimated that it
728 “saved” money and “lost” money for 2000-2002 (Stipulated Exhibit 17, NIC
729 002777 & Stipulated Exhibit 18, NIC 110776).

730 Q. What are the PBR Buckets reports?

731 A. This portion of my testimony addresses the Company’s own calculations of the

732 sources of its savings under the PBR in order to show that the so-called LIFO
733 decrement accounts for the bulk of the savings over the life of the program. At a
734 later point in my testimony, I will demonstrate that these reports should have
735 been disclosed to Staff and CUB in response to data requests before the
736 existence of the whistleblower fax came to light in July 2002.

737 The buckets reports are spreadsheets created by the Company to quantify and
738 categorize the savings and losses under the PBR. They were distributed
739 throughout the Company on a monthly basis, updating management on the
740 status of the program. At the end of each year, a final buckets analysis was
741 performed which would show the same amount of savings that was reported to
742 Staff. On each report, the total savings under the PBR was calculated up to that
743 point in the year. Then that total was categorized under headings such as
744 "Decrement Value" and "Storage Credits" among others (Stipulated Exhibits 17
745 and 18, as well as NIC 110775 and NIC 110777).

746 In her deposition, Beth Hohisel recalled receiving NIC 002776, a two-page
747 document with a memo from Patrick Davis. (Hohisel Transcript, p. 124) The
748 subject of the memo is "Final Buckets Analysis for 2001." Ms. Hohisel described
749 the attachment, PBR Buckets, as "a look at the total savings that was generated
750 for gas costs versus the benchmark. And with estimates breaking down some of
751 the components." (Hohisel Transcript, p. 124) She described the categories
752 within the PBR Buckets as "matching more with the benchmark itself and the

categories of the benchmark.” (Id., p. 127) George Behrens also testified that he became familiar with the form of the report during the PBR years. (Behrens Transcript, p.71) He stated that the PBR Buckets reports were a communication tool produced by the supply group to communicate, “progress toward PBR results during the year.” (Id., p. 77) He also indicated that they were an attempt to quantify the PBR results including the PBR savings. (Id., p. 78) Ms. Halloran also testified that she was familiar with the PBR Buckets Reports. (Halloran Transcript, p. 130) She testified she saw them at meetings where the performance of the PBR and how it might be going was discussed. (Id., p. 131)

Q. Who prepared the PBR Buckets reports?

A. These documents were recognized by Rich Rayappan, Beth Hohisel, and Jeff Metz, all of whom indicated they were familiar with the PBR Buckets reports and that they were generated internally at Nicor. (See Rayappan Transcript, p 104, Hohisel Transcript, p. 125, and Metz Transcript p. 141) Rich Rayappan confirmed that one of his staff in Supply Accounting, Patrick Davis authored NIC 002776-7. (Rayappan Transcript, p. 105) The similarities between Stipulated Exhibits 17 and 18 support the conclusion that Patrick Davis was also the author of Stipulated Exhibit 18.²

² Nicor has stipulated that NIC 002777 and 110776, Stipulated Exhibits 17 and 18, respectively, were produced by Nicor in discovery in this matter. The formats of the two Exhibits are not identical, but bear a striking similarity,

771 Q. What was the basis for the PBR Buckets Reports?

772 A. Mr. Rayappan explained, "certain numbers on here are based on amounts we
773 recorded on the books. Some are based on calculations or estimates."

774 (Rayappan Transcript, p. 105.) He explained that of the various components,

775 some were recorded on the books and some were the result of calculations or

776 estimates. He identified which of the components were recorded on Nicor's

777 books and which were the result of calculations. (See Id., pp. 106-107) Mr.

778 Rayappan stated unequivocally that the total PBR Savings is an accurate

779 number. (Id., p. 109) Similarly George Behrens testified that he had no reason

including the rectangle at the top of each. The rectangle in SE 17 includes the notation:

PBR Buckets
December, 2001

while the rectangles in SE 18 (NIC 110776), as well as in NIC 110775 and 110777, include the following notation:

PBR Buckets
December, 2002[.]

Also in terms of formatting, the bottom lines of the latter three documents (NIC 110775, 110776, and 110777) show the same author but different times and dates of creation, as well as different filenames, as follows: Stipulated Exhibit 18 (NIC 110776) bears the notations, reading from left to right, "12/27/2002 11:44 AM," "2002 Buckets 12-7net.xls," and "Patrick Davis." NIC 110775 bears the notations "12/26/2002 3:25 PM," "2002 Buckets 12-27net.xls," and "Patrick Davis." NIC 110777 bears the notations "05/21/2003 1:10 PM," "2002 Buckets2-21net.xls," and "Patrick Davis."

Patrick Davis was employed by Nicor Gas from May 15, 2000, until February 26, 2005, holding titles including the word "Accountant" from May 15, 2000, until July 17, 2004 (Nicor Gas response to Staff data Request 43.01).

780 to believe the numbers on NIC 002777 were not reliable. (Behrens Tr., pp. 179-
781 180) He identified some line items which he testified were verifiable. (Id., pp.
782 180-182) Mr. Behrens also agreed that the numbers were important to Nicor and
783 help form the basis of whether it made or lost money. (Id., p. 182)

784 Q. What was the purpose of the PBR Buckets Reports?

785 A. Ms. Hohisel indicated that the reports were “generated along the way to provide
786 some communication to... upper management and those not directly involved
787 with the PBR, so that they knew what the estimated – what the savings were.”
788 (Hohisel Transcript, p. 125) Jeff Metz testified that the PBR Buckets Report was
789 a report that “attempts to identify where the value under the PBR was achieved.”
790 (Metz Transcript, p. 140) He described it as “the supply department’s best
791 estimate of general categories of where costs or benefits were coming from.”
792 (Id., p. 142) Neither Ms. Hohisel nor Mr. Metz was aware of any other analysis
793 which calculated what savings were generated from the various PBR strategies.
794 (Hohisel Transcript, pp. 134; Metz Transcript, p. 143) They described it as being
795 the most accurate description the Company had of how savings were generated.
796 (Hohisel Transcript, pp. 133-134; Metz Transcript, pp. 143-144) Mr. Metz
797 testified that it was important for Nicor officers to be aware of where the PBR
798 savings were coming from as they needed to understand if there were certain
799 areas that should be pursued further and where the risks were. (Metz Transcript,

800 p. 144)

801 The cover memorandum (NIC 002776) for Stipulated Exhibit 17 (NIC 002777)
802 indicates that it was addressed to Phil Cali, Len Gilmore, Beth Hohisel, John
803 Madziarczyk, Rich Rayappan, George Behrens, Al Harms, Ted Lenart, Jeff Metz,
804 and Lonnie Upshaw. Mr. Metz testified that as well as some of the foregoing,
805 Tom Fisher and Kathy Halloran were present at the meetings he attended where
806 the PBR Buckets Report was discussed. (Metz Transcript, p. 141)

807 Q. Looking at the PBR Buckets Report (Stipulated Exhibit 17), what does 'PBR
808 performance without Decrement' reference?

809 A. According to Beth Hohisel, that referenced the "estimated value before LIFO
810 inventory layers." (Hohisel Transcript, p. 128)

811 Q. What does 'Inventory Decrement and Inventory Balance at year-end', at the
812 bottom of the PBR Buckets (Stipulated Exhibit 17) reference?

813 A. According to George Behrens' testimony, this referenced the "value of the
814 reduction in LIFO inventory that occurred in 2000 and 2001". (Behrens
815 Transcript, p. 91)

816 Q. According to the PBR Buckets Reports, where did Nicor estimate it saved or lost

817 money during 2000-2002?

818 A. Nicor calculated that in 2000, it lost \$4.4 million on the totality of its PBR
819 performance without the decrement; the decrement value was \$28.8 million
820 resulting in total PBR savings of \$24.4 million. (See Stipulated Exhibit 17) In
821 2001, Nicor saved \$10 million through its PBR program without the decrement;
822 the decrement value added and additional \$19.7 to the PBR savings for a total of
823 \$29.7 million. (Id.) In 2002, Nicor calculated that it saved \$9.8 million through the
824 PBR program; the decrement value added \$19.5 million, for a total savings of
825 \$29.3 million. (Stipulated Exhibit 18)

826 Q. Overall, what was the effect of the LIFO decrement on Nicor's PBR
827 performance?

828 A. Based upon the calculations I discussed in my previous answer, during the PBR
829 program, Nicor attributed \$68 million to the LIFO decrement. This is over 81% of
830 the total \$83.4 million in savings for the entire PBR program. Nicor employee, Al
831 Harms, has a similar viewpoint:

832 Q. *As [you] sit here today, how did Nicor earn the bulk of the savings in the*
833 *PBR?*

834 A. *From my viewpoint, it's very difficult to look at individual transactions and*
835 *say how much savings that they generated.*

836 *I think, if you look in total, based upon the calendar year reports that would*
837 *go to the Commission and to Staff, the bulk of the savings as shown under*

838 *there would have come from the inventory decrement.*

839 Q. *Do you concur with that, or do you have a different idea where the savings*
840 *come from?*

841 A. *I would concur with that. (Harms Transcript, pp.128-129)*

842 When you consider that the benchmark was inflated, as I have previously
843 discussed and Mr. Zuraski will explain further, that leaves very little “savings”, if
844 any, which can be attributed to actual improved performance by Nicor. In fact,
845 according to the Buckets reports referenced above, the Company estimated that
846 it lost \$37.7 million during the PBR from the Commodity component alone. This
847 Commodity component measures, among other things, the prices at which Nicor
848 is purchasing gas for customers. It is fairly clear from these numbers that Nicor
849 did little, if anything, to actually improve its purchasing strategies to benefit
850 customers. Nicor employee, Mr. Metz, echoes my belief:

851 *“Absent the use of LIFO value, it did not look like we were able to perform at*
852 *reducing gas costs.” (Metz Transcript, pp. 204-205).*

853 And finally, former Nicor Vice President, Mr. Upshaw, gives his assessment of
854 Nicor’s performance under the PBR:

855 Q. *I’m just kind of curious, did the supply department, did your department,*
856 *ultimately make money under the PBR? And you can refer to the report,*
857 *it’s not a trick question.*

858 A. *I believe the best way to answer that is that on certain parts of this we*
859 *made money and on certain parts we lost money. Overall, if you took*
860 *away the [LIFO] decrement, overall we would have had some losses.*

861 *(Upshaw Transcript, pp. 182-183).*

862 Q. Nicor witness Bartlett states that during the PBR, Nicor had the lowest gas costs
863 among the six largest Illinois natural gas utilities. (Nicor Ex. 1.0, p. 4). How was
864 Nicor able to divert tens of millions of dollars from ratepayers, as Staff suggests,
865 and yet keep gas costs low for ratepayers?

866 A. Most of Nicor's gains occurred from liquidating the low-cost LIFO layers from
867 storage. This did not cost ratepayers anything in the short term, but rather
868 reduced potential gains for ratepayers in the long term. Think of the LIFO gas in
869 storage as an attic full of antiques passed down for generations. These antiques
870 have great worth on the open market and you could profit greatly from selling
871 them. If a fire were to destroy all of those antiques, the immediate monetary loss
872 would be negligible since they cost you next to nothing to acquire and store
873 them. However, your opportunity losses would be great, as you could have sold
874 them down the road for a large profit. Thus the fire did not cost the owner any
875 money directly out of pocket but it did cause the owner lost value in the future.
876 Nicor's actions operated the exact same way. The Company took an asset that
877 had great future value to ratepayers, and sold it, perhaps for less than it would
878 have been worth later, all the while taking 50% of the profits. This is how gas
879 costs remained steady while Nicor profited on the backs of ratepayers.

880 **Nicor's Improper Practices, Transactions, and Conduct**

881 Q. Has Nicor engaged in improper practices, transactions and conduct during the
882 PBR program?

883 A. Yes. Some of these were described in the Lassar report (Stipulated Exhibit 6),
884 which was later adopted by the Company.

885 Q. Would Staff have uncovered any of Nicor's misconduct were it not for the
886 whistleblower memo to CUB?

887 A. No, it is extremely doubtful that Staff would have uncovered many, if any, of
888 Nicor's improper transactions. In fact, Staff and the other parties had basically
889 concluded the PBR review case of 02-0067 when the whistleblower memo was
890 distributed. Up to that point, Staff had not identified any of the issues that are a
891 part of our case today. However, Staff did not rely upon the whistleblower memo
892 as a basis for any of its analysis or conclusions. Rather, the whistleblower memo
893 was a catalyst for further in-depth discovery from Staff and other parties. It is the
894 information from data request responses, testimony, and depositions that Staff is
895 relying upon as a basis for its positions.

896 Q. Regarding the reasons why Staff didn't uncover Nicor's schemes during the 99-
897 0127 and 02-0067 docketed cases, did Staff fail to ask the right questions during

898 those cases?

899 A. No. Staff did its best to investigate all angles during those two cases, given the
900 complexity and uniqueness of the issues at hand. In fact, as I will show, Staff
901 and the intervening parties did indeed ask questions during the cases that would
902 have revealed some of Nicor's improprieties, had Nicor answered completely and
903 truthfully.

904 **Buckets Reports**

905 Q. How are the buckets reports related to improper conduct on the part of Nicor?

906 A. The buckets reports are first mentioned earlier in my testimony, in the context of
907 establishing the Company's own calculations of the sources of their "savings"
908 under the PBR. This section of my testimony addresses the fact that the
909 Company generated those documents, had them in their possession, and did not
910 furnish them to Staff and CUB after Nicor had received certain data requests
911 from Staff and CUB.

912 Q. Were the buckets reports accurate?

913 A. They were the most accurate reports that the Company had which analyzed and
914 quantified the savings and losses under the PBR. While a few of the numbers
915 were the best estimates of the Company, many of the numbers were known to be

916 accurate. It is important to remember that was the report that managers relied
917 upon to monitor and analyze the profitability of the PBR. This report was not just
918 some “back of the napkin” calculation; this report was the Company’s best
919 attempt to track tens of millions of dollars of savings and losses. It is clear that
920 Nicor’s own employees believed in the accuracy of the buckets reports:

921 *Theodore Lenart:*

922 Q. *Did you believe that the report was accurate from an accounting point of*
923 *view?*

924 A. *Yes. (Lenart Transcript, pp. 107-108).*

925 *Jeffrey Metz:*

926 Q. *So this is the most reliable document that the individuals at that meeting*
927 *had to make any determination as to what savings were generated from*
928 *what strategies?*

929 A. *Yes.*

930 Q. *Do you think it was important for Nicor to be aware, Nicor meaning the*
931 *various officers who were making decisions where the PBR savings was*
932 *coming from?*

933 A. *Yes.*

934 Q. *Why?*

935 A. *They mostly need to understand if there are certain areas you should*
936 *pursue further or where the risks were.*

937 Q. *And to your knowledge, is this the document that they relied upon to make*
938 *those determinations?*

939 A. *I think this document was used as a communication vehicle to the officers*
940 *of where the Supply Department stood and where they expected to be. (Metz*
941 *Transcript, pp.143-144).*

942 *Beth Hohisel:*

943 Q. *Then did the Company have a more accurate description of how the*
944 *savings were generated?*

945 A. *More accurate than?*

946 Q. *The buckets reports?*

947 A. *Buckets, no. (Hohisel Transcript, p. 133).*

948 Q. Did Staff ever see the buckets reports prior to reopening of 02-0067 due to the
949 whistleblower fax?

950 A. No. However, it is my belief that Staff should have been given access to these
951 reports in response to several data requests. In early 2002, Staff sent request
952 number POL 1.2 (Stipulated Exhibit 8), which asked Nicor to describe all actions
953 taken by Nicor to save money under the PBR, and to identify the savings for
954 each action. Nicor responded with a very vague and incomplete description of its
955 actions and said, "The Company does not track gas costs or savings in the
956 manner requested."

957 Staff followed that response with another request, numbered POL 2.1 (Stipulated
958 Exhibit 9). This request asked for, among other things, "the Company's best
959 estimate of the total cost of the actions taken by the Company to reduce gas
960 costs since the inception of the GCPP." The Company again responded that it
961 was "impossible" to identify either the actions taken or the costs associated with

962 such actions.

963 Finally, CUB also sent a request to Nicor, numbered 1.17 (Stipulated Exhibit 10),
964 which asked the Company to categorize the savings realized under the PBR.
965 Many of the categories listed by CUB were categories that Nicor itself had
966 identified in response to POL 1.2. There was also a catchall category called
967 "other." Once again, Nicor responded by saying that categorized savings were
968 not available.

969 Nicor's repeated assertions that it was not able to quantify or categorize savings
970 into individual components were untrue. Nicor had been collecting this exact
971 information since early 2000. Not once did Nicor provide Staff or CUB with the
972 buckets reports, or even so much as admit to their existence. It is my belief that
973 Nicor didn't want Staff to see these reports because they would have alerted
974 Staff to actions such as the LIFO decrement.

975 Q. Do any of Nicor's employees think that the buckets reports should have been
976 provided in response to these data requests?

977 A. Yes. Here are a few examples of the thoughts of Nicor's officers:

978 *George Behrens, Treasurer and Vice President of Administration:*

979 Q. Okay. Do you think that the PBR buckets report is responsive to 1.17?

980 A. *I think it may be responsive to 1.17.*

981 Q. *Okay. Would I be correct in saying that if you had thought about it that*
982 *you would have included Document 2777 in your answer?*

983 A. *I think I may have. (Behrens Transcript, p. 178).*

984 *Jeffrey Metz, Vice President and Controller:*

985 Q. *[Is it your opinion] that the document, the PBR buckets document we were*
986 *just talking about identified as NIC 02777 should have been provided in*
987 *response to CUB 1.17 by the Company?*

988 A. *In my opinion, yes. (Metz Transcript, p. 179).*

989 Q. *Do you have an opinion on whether the Company should have turned over*
990 *the buckets analysis NIC 002777 in response to Staff's Data Request POL*
991 *2.1?*

992 A. *It appears to me, yes. (Metz Transcript, pp. 181-182).*

993 **Directive to Hide LIFO from Staff**

994 Q. Did Staff realize Nicor's potential to profit from the low cost LIFO storage gas
995 through the PBR?

996 A. As I stated earlier, Staff was not aware of this possibility. Furthermore, Nicor did
997 its best to ensure that this possibility never crossed the minds of Staff. Nicor
998 repeatedly told Staff in data request response and witness testimony that it could
999 not manipulate storage injections and withdrawals. Moreover, Nicor employees
1000 believed there was a corporate directive that no employee was to inform Staff of

1001 the LIFO benefit unless asked a direct question. Even when Staff did ask direct
1002 questions, such as POL 1.2 and 2.1, Nicor was not forthcoming with regards to
1003 its LIFO decrement. Indeed, Nicor has given many vague, misleading, and even
1004 false responses to Staff's data requests during 99-0127 and 02-0067.

1005 Q. What do you mean when you say that Nicor had a corporate directive to hide the
1006 LIFO benefit from Staff?

1007 A. Several Nicor employees have stated that they understood that they were not
1008 supposed to highlight the LIFO benefits to Staff. It is unclear who gave this
1009 directive, but it seems to be a widely shared belief that there was indeed such a
1010 directive. Consider the sworn depositions of several Nicor employees:

1011 *Theodore Lenart:*

1012 Q. *Did you have a general understanding that the Company's use of LIFO*
1013 *layers under the PBR was not to be highlighted to either the Commission*
1014 *staff or interveners?*

1015 A. Yes.

1016 Q. *And where did you get that general understanding from?*

1017 A. *Just discussions from time to time about LIFO in general.*

1018 Q. *And who did those discussions take place with?*

1019 A. *Just about everyone that we worked with. (Lenart Transcript, p. 66).*

1020 *Leonard Gilmore:*

1021 Q. *Was part of the strategy that you developed to not highlight the use of the*
1022 *LIFO inventory?*

1023 A. *I would say that part of the strategy was to not highlight LIFO. I do not*
1024 *recall that I developed that part of the strategy. (Gilmore Transcript,*
1025 *p.116).*

1026 *Jeffrey Metz:*

1027 Q. *When you did -- when you consulted with Mr. Werneke in 1999 to prepare*
1028 *his testimony, was it your intent to be careful not to highlight the LIFO*
1029 *benefit in that testimony?*

1030 A. *Yes.*

1031 Q. *And why was that?*

1032 A. *Because -- well, two reasons. There was my understanding it was a*
1033 *directive not to highlight. And two, I believe we were advised by counsel*
1034 *that we had no obligation to highlight it. (Metz Transcript, p. 166).*

1035 *George Behrens:*

1036 Q. *Did you have any concerns about the staff finding out about the*
1037 *company's use of LIFO, the effect that may have on the PBR?*

1038 A. *Yes.*

1039 Q. *Why?*

1040 A. *There was always the potential that the PBR formula could be modified.*
1041 *(Behrens Transcript, pp. 60-61).*

1042 Q. *What was your concern?*

1043 A. *My concern was that in a case providing more information of variety of*
1044 *types results in an uncertainty of outcome. (Behrens Transcript, p. 67).*

1045 * * *

1046 Q. *There's no explicit reference to low cost LIFO layer in this testimony*
1047 *[Behrens Direct Testimony in Docket 02-0067]. Right?*

1048 A. *Yes.*

1049 Q. *There was a conscious decision made to not include it in the testimony,*

1050 *correct?*

1051 A. *To not refer to low cost LIFO layers?*

1052 Q. *Right. Right.*

1053 A. *Yes.*

1054 Q. *It's your testimony, you're owning it, right?*

1055 A. *Yes. (Behrens Transcript, pp. 172-173).*

1056 It is evident from these statements that the directive to hide the LIFO benefit from
1057 Staff originated at the beginning of the 99-0127 case. Mr. Behrens admits that if
1058 Staff had known of the Company's intentions to monetize the LIFO layers, it was
1059 very likely that Staff would have proposed a different (and, it is fair to infer, less
1060 favorable) benchmark for the Company. So from day one, Nicor made a
1061 conscious effort to refrain from discussing LIFO layers in any filing, testimony, or
1062 data request response.

1063 Q. Do you have any written documentation of this directive to hide the LIFO strategy
1064 from Staff?

1065 A. Yes. NIC 011420-22 (Stipulated Exhibit 19) is a memo from Company employee
1066 Jeffrey Metz to his personal file, dated August 4, 2000. Mr. Metz identified this
1067 as a memo he had written to himself. (Metz Transcript, p. 32) He stated that he
1068 often wrote memos to himself because "writing through issues helps me logically
1069 think through and get to conclusions and it also serves as a memory refresher as
1070 to who *sic* I reached the conclusion. So usually I just write numerous memos to
1071 my file and refer to them later." (Id., p. 33)

1072 In this memo he says,

1073 "Quarterly, Al Harms communicates our PBR results to [ICC]
1074 staff. He provides them a worksheet showing which
1075 components produced the result. We will need to be careful
1076 to not highlight the LIFO benefit. In the actual year-end PBR
1077 computation, the LIFO benefit will be very difficult to
1078 recognize. It may be more transparent on an interim basis."

1079 Mr. Metz was questioned about this Note:

1080 Q. Explain to me what you were referring to in that note?
1081
1082

1083 A. It's referring to providing voluntarily quarterly reports to the Illinois
1084 Commerce Commission as to how we were performing under the
1085 PBR. And that it would be, in my mind, this is restating the fact that
1086 we shouldn't highlight the LIFO issue unless it was asked about.
1087

1088 The reason that I would have put the note there is that -- to remind
1089 myself that that's going to be very difficult. The LIFO issue would
1090 stand out pretty clearly on any type of interim report if we had LIFO
1091 at that point in time.
1092

1093
1094 At this point in time, there was no LIFO benefit. So it's simply a
1095 note to myself recognizing what I believe was the directive to not
1096 highlight it, and recognizing that that would be pretty difficult to do.
1097 (Metz Transcript, pp. 33-34)
1098

1099 Up to that point, there had been no LIFO decrement under the PBR program.

1100 The language quoted from this memorandum demonstrates that Mr. Metz
1101 recognized, and documented, that the quarterly reports Mr. Harms was providing
1102 to Staff created a risk that Staff would recognize the LIFO benefit. The sentence
1103 "We will need to be careful to not highlight the LIFO benefit" unambiguously

1104 documents that Nicor personnel recognized the danger of the discovery of the
1105 LIFO benefit outside the Company. This is substantiated by Mr. Metz's sworn
1106 deposition:

1107 Q. *How would the LIFO benefit stand out in an interim report?*

1108 A. *Because the PBR Benchmark is an annual benchmark, so in the annual*
1109 *report you would show the computation of the benchmark, and then you*
1110 *would show the gas cost.*

1111 *On an interim basis it was not possible to calculate the benchmark on any*
1112 *interim basis.*

1113 *So to try to determine how you were performing at an interim point in time,*
1114 *we had to try to make some estimates of the various components of where*
1115 *we were performing. And that could involve the firm deliverability costs,*
1116 *that could involve the commodity costs, and that could involve the*
1117 *inventory.*

1118 *So trying to draft a report to show how we were performing, if you are*
1119 *trying to show the components, I couldn't envision how you could not*
1120 *show inventory. Because you could not show a benchmark on an interim*
1121 *basis.*

1122 * * *

1123 Q. *So the format that you used to generate the reports would have to change*
1124 *in order for the LIFO not to be apparent from it?*

1125 A. *Yes. (Metz Transcript, pp. 34-36).*

1126 Q. Did Nicor in fact change the format of these reports to Staff, thus obscuring the
1127 LIFO benefit?

1128 A. Yes. On the first two quarterly reports, there was a category named "Gas
1129 Commodity." If there had been any LIFO decrement in the first two quarters, it

1130 would not have been included in Gas Commodity, but would likely have been
1131 classified under its own category, much as it is in the monthly buckets reports.
1132 However, when there finally was a LIFO decrement in the third quarter, Nicor
1133 changed the name of the "Gas Commodity" category to be "Gas Commodity and
1134 Storage." By accounting for the LIFO decrement in this hybrid category, Nicor
1135 effectively hid the decrement from Staff, as it was impossible to determine from
1136 where the savings actually came. So not only did Nicor fail to tell Staff during the
1137 99-0127 case that it would be monetizing the LIFO layers, Nicor also went so far
1138 as to alter reports so that the LIFO decrement would be concealed.

1139 Q. Does this conclude your direct testimony?

1140 A. Yes.